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Highlights of Major Japanese Automakers' Financial Results for Fiscal Year Ended March 2018

The following is Japan Credit Rating Agency, Ltd. (JCR)'s perception of the current status and highlights for rating concerning the financial results for the fiscal year ended March 2018 (FY2017) and earnings forecasts for FY2018 of Japanese automakers.

1. Industry Trend

Japan's eight listed automakers (excluding HINO MOTORS, LTD. ("HINO"), a consolidated subsidiary of TOYOTA MOTOR CORPORATION ("TOYOTA")) achieved a 3.1% year-on-year growth of their worldwide new car sales in FY2017 to reach 27,617 thousand units. In the medium-to-long-term forecast for worldwide new car sales, moderate growth will be expected. However, the current conditions show scatter in sales depending on the region. According to NISSAN MOTOR CO., LTD. ("NISSAN")'s financial reporting for FY2017, growth rate of demand for worldwide new cars was 1.9% in FY2017 and that in FY2018 is expected to be 2.0%. By market, these growth rates are 2.4% and minus 1.9% in Japan, minus 1.0% and minus 2.9% in the U.S., 2.7% and 1.2% in Europe (including Russia), and 1.8% and 6.3% in China (on a calendar year basis for China only).

A high growth rate of vehicle sales in the Japan market in FY2017 is largely attributable to a reaction to negative effect of fuel economy tests manipulation in FY2016 and is expected to fall gradually over the medium to long term. The new car sales in the U.S. market after the course of the replacement cycle that followed the global economic slowdown peaked out in 2016 and have since been shrinking. There remain trade and commerce risks such as re-negotiation on North American Free Trade Agreement (NAFTA). The European market is expanding moderately but facing uncertainties including political issues such as Brexit, i.e. the U.K.'s withdrawal from the EU. In China, the growth became slower due to the moderation of a tax relief measure for compact passenger cars but has recently been driven by good sales of sport utility vehicles (SUVs). While sales are recovering in Thailand and other countries in Southeast Asia, demands are still weak in the Middle and Near East countries.

Development of electric vehicles (EVs) has been accelerated in the automotive industry against the background of stricter environmental regulations in each country. Competition for developing an automated driving system is intensified. While there is an urgent need for response to such new technologies, there is a concern about a risk of increasing tax cost due to the new government's trade protectionist policies. Under the business environment, business alliances are being made in an increasing number of cases to address the needs for technological development of EV, etc. and increase of overseas local production. For instance, Mazda Motor Corporation ("Mazda") concluded an agreement on business capital alliance with TOYOTA in August 2017 for joint technology development of EV and establishment of a joint company for finished car production in the U.S.

2. Financial Results

Due to an increase in domestic sales of new cars as well as a benefit from the weaker yen in FY2017, total net sales of the eight companies increased 7.0% from a year earlier and total operating income increased 9.7% year on year to 4,973.2 billion yen. The operating income increase/ decrease analysis (of data from the three companies of TOYOTA, HONDA MOTOR CO., LTD. ("HONDA") and NISSAN) shows that primary factors for the increase of operating income were "cost reduction" including cost improvement, fluctuations in raw materials prices, decrease in fixed cost, etc. for 330.6 billion yen, and "fluctuations in currency exchange rates" for 282.2 billion yen, while primary factors for the decrease include "volume/ model mix" for 75.9 billion yen and an increase in expenses. The upwardly revised operating income despite the initially projected 11.5% year-on-year decrease in operating income was primarily attributable to the fact that the initially expected "fluctuations in currency exchange rates" for the decrease of 265.0 billion yen changed to a factor for the increase of 282.2 billion yen due to the benefit from the yen's depreciation. "Cost reduction" was smaller than usual because the rise in prices of raw materials such as steel products eliminated a part of effects of cost reduction activities.

“Volume/ model mix” is cited as a factor for the decrease of operating income is that some automakers assume severe earnings environments in the U.S. and other countries.

Many of Japanese automakers depend on the U.S. market in terms of income. In the U.S. market, demands have been shifting from sedan cars, which Japanese automakers are good at, toward SUVs, pickup trucks, etc. Automakers incurred heavy expenses of sales incentives for source of funds to make discounts on new car prices in fierce competition, which put downward pressure on incomes. Operating income in the North America segment (of the major three automakers) decreased almost 40% to 617.2 billion yen in FY2017 from 997.6 billion yen in FY2016. According to NISSAN’s financial report for FY2017, sales incentives in the U.S. are assumed to be a factor for a decrease of 60.4 billion yen.

On the financial front, all companies increased net assets through profit accumulation as well as an increase in foreign currency translation adjustments resulting from weaker yen as of the end of FY2017. Some companies performed buyback of their own shares but saw only limited impact on financial indicators. TOYOTA and NISSAN’s net cash amount (difference between ready liquidity and interest-bearing debts; based on liquid assets for TOYOTA) for the Automotive segment excluding sales finance amounted to about 9.8 trillion yen as at end-March 2018, as opposed to about 3.1 trillion yen as at end-March 2008). When looked at automakers other than the major two, Mazda turned around to the net cash position of 35.4 billion yen at the end of FY2016 and has maintained its net cash position of 107.0 billion yen at the end of FY2017.

3. Highlights for Rating

According to the eight companies’ combined business forecast for FY2018, the units of worldwide new car sales in FY2018 will increase 2.4% year on year, showing that car sales business itself will remain firm. In contrast, sales volume is projected to increase no more than 0.2% and operating income to decrease 8.1% from a year earlier. The operating income margin is forecast to fell to 6.4% from 6.9% for FY2017. The operating income increase/ decrease analysis (of data from the three companies) forecasts that primary factors for an increase in operating income will be “cost reduction” for 261.0 billion yen, while “fluctuations in currency exchange rates” as a primary factor for a decrease of 572.0 billion yen. Accordingly, operating income will increase by 303.7 billion yen after the elimination of negative impact from fluctuations in currency exchange rates. In terms of fluctuations in currency exchange rates, the export profitability is expected to worsen with the assumed exchange rate for the dollar of 105 yen by most of the companies as opposed to about 111 yen for FY2017. Some companies anticipate that negative impact of non-US dollar currencies will increase along with expansion of overseas sales channels in recent years. A rise in raw material prices has lesser effects than those in FY2017. Nevertheless, many companies have a certain amount of higher raw material prices’ effect reflected in their forecast and “cost reduction” still remains at a low level accordingly. Capital investments are projected to increase 9.9% year on year, showing that many companies are planning to actively invest in vehicle electrification, automated driving system, etc. with an eye to the future.

In terms of impacts on the automakers’ business performance, attention needs to be paid to currency movement as well as control of a decline in income in the U.S. where sales incentives are costly. Recently, some companies curb cost of sales incentives by changing major sedan models and strengthen their SUV production system.

Political issues such as the U.S. government’s trade protectionist policies and Brexit arouse concern about a risk of increasing tax cost. Any increase in a tariff through NAFTA review will generate problems of local production expansion in the U.S. and increasing tax cost absorption.

It is highly possible that an increase in EV sales will cause cost rises for automakers in the medium to long term. Attention will be paid to whether the current profitability can be maintained through improvement of development efficiency, for instance, TOYOTA’s Toyota New Global Architecture (TNGA) and NISSAN’s new-generation vehicle design technology Common Module Family (CMF). Since EV does not need internal combustion and therefore has a relatively simple structure, assembly of components or parts which Japanese automakers excel at may become less important. Internal combustion engine will likely continue to be a major automotive power train for a considerably long time to come. Be that as it may, each of automakers as well as parts manufacturers affiliated with them will need to flexibly respond as an entire group to the times when EV become mainstream of cars.

Intensifying competition in technological development for vehicle electrification, an automated driving system, etc. is raising automakers’ capital investments and R&D expenses. The key is how the automakers can maintain and strengthen their financial structure in the face of intensified competition for development.

After Volkswagen AG's diesel emissions troubles and Mitsubishi Motors' falsification of fuel economy test data, improper inspection on finished vehicles by NISSAN and SUBARU (misconduct in quality checks of finished cars at domestic plants) drew attention in 2017. These are significant problems in light of compliance and management control system. JCR will continue to follow impacts on their brand image and car sales, effectiveness of recurrence prevention measures, etc.

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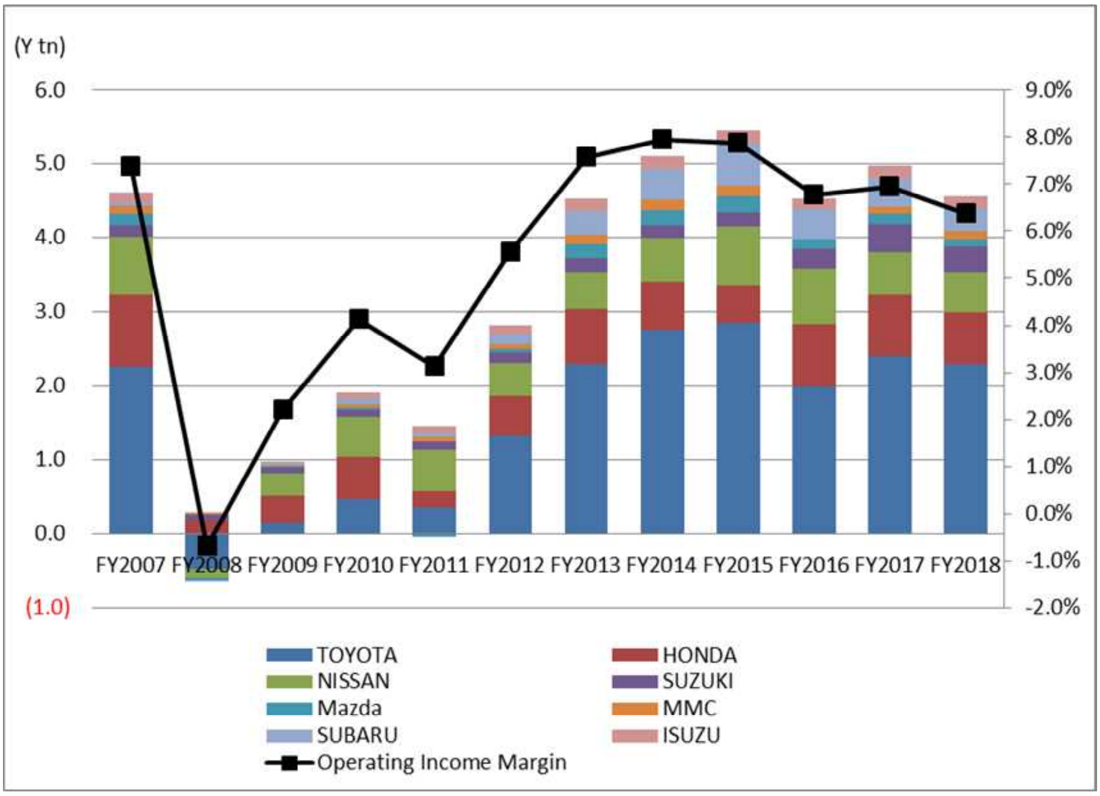
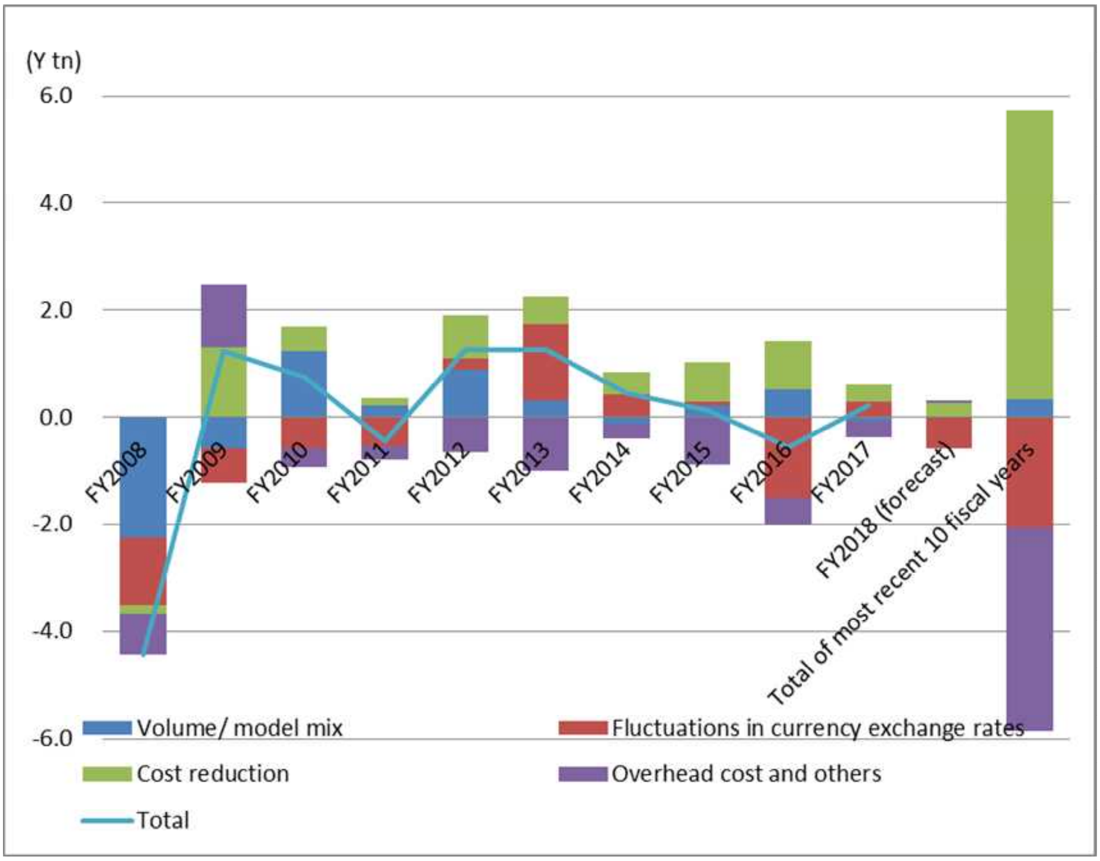
(Chart 1) Consolidated Operating Income and Operating Income Margin of 8 Listed Automakers



(Source: Prepared by JCR based on financial materials of the above companies)

Note: (excluding HINO MOTORS, LTD. ("HINO"), a consolidated subsidiary of TOYOTA MOTOR CORPORATION ("TOYOTA"), from the nine listed companies)

(Chart 2) Factors for Change of Operating Income of Top 3 Companies



(Source: Prepared by JCR based on financial materials of the top three companies)

Note: Top three companies are TOYOTA, HONDA and NISSAN.

<Reference>

Issuer: NISSAN MOTOR CO., LTD.

Long-term Issuer Rating: AA- Outlook: Stable

Issuer: ISUZU MOTORS LIMITED

Long-term Issuer Rating: A Outlook: Positive

Issuer: TOYOTA MOTOR CORPORATION

CP: J-1+

Issuer: Mazda Motor Corporation

Long-term Issuer Rating: A- Outlook: Stable

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